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## Security Interests

### Recommendations of the draft Legislative Guide on Secured Transactions

#### Report of the Secretary General

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## **Recommendations of the draft Legislative Guide on Secured Transactions**

### **I. Scope**

#### **Purpose**

1. The purpose of the scope provisions of the secured transactions law (hereinafter referred to as “the law”) should be to specify the parties, the security rights, the secured obligations and the assets to which the law applies.

#### **Security rights**

2. The law should deal with security rights in movable property and fixtures securing payment or other performance of one or more obligations, present or future, determined or determinable.

#### **Parties, security rights, secured obligations and assets covered**

3. The scope of the law should be as broad as possible with respect to the parties, and the types of security rights, secured obligations and encumbered assets covered. Any exceptions should be limited and clearly stated in the law.

4. In particular, the law should apply to:

(a) Legal and natural persons, including consumers;

(b) Rights created contractually to secure all types of obligations, including future obligations, fluctuating amounts of obligations and obligations described in a generic way;

(c) All types of movable assets and fixtures, tangible or intangible, not specifically excluded in the law, including inventory, equipment and other goods, receivables, [cheques, promissory notes, deposit accounts, letters of credit and intellectual property rights], as well as proceeds of those assets; [*Note to the Working Group: If the Working Group decides that such types of asset should be covered in the draft Guide, it may wish to review the recommendations to ensure that they are appropriate for those assets as well and to add special recommendations where necessary.*]

(d) Rights in all assets of a grantor; and

(e) Security by way of transfer of title [and all other types of rights securing the payment or other performance of one or more obligations, irrespective of the form of the relevant transaction and whether ownership of the encumbered assets is held by the secured creditor or the grantor]. [*Note to the Working Group: The Working Group may wish to consider: (i) including retention of title in the legislative regime recommended and give it preferential treatment for priority or other purposes; (ii) exclude at least simple retention of title from the legislative regime recommended but subject it, with some exceptions, to registration for the purpose of addressing priority conflicts; (iii) exclude at least simple retention of title, from the legislative regime recommended. See also Recommendations 10, 27, 43, 72, 76, 82 and 86.*]

5. The law should not apply to security rights in:
  - (a) Securities; and
  - (b) [...].

## II. Creation

### Purpose

6. The purpose of the provisions of the law dealing with creation is to specify the way in which a security right in movable property is created as between the grantor and the secured creditor.

### Security agreement

7. The law should specify that a security right is created as between the grantor and the secured creditor by security agreement.

### Delivery of possession

8. The creation of a possessory security right requires, in addition to agreement, the delivery of possession of the assets to be encumbered to the secured creditor or another third party who holds the assets on behalf of the secured creditor (other than the grantor or an agent or employee of the grantor) (see recommendation 28).

### Minimum contents of the security agreement

9. The law should provide that the security agreement must, at a minimum, identify the secured creditor and the grantor and reasonably describe the secured obligation and the assets to be encumbered. A generic description of the secured obligation and the encumbered assets should be sufficient.

### Form

10. The law should provide that the security agreement must be in writing which need not be signed as long as the intention of the grantor to grant a security right is clearly reflected in the document [*Note to the Working Group: The Working Group may wish to limit the writing requirement to non-possessory security. The Working Group may also wish to exclude simple retention of title, from the writing requirement.*]

11. The law should specify that a data message may satisfy the requirement of a writing provided that the information contained therein is accessible so as to be usable for subsequent reference (see article 6 of the UNCITRAL Model Law on Electronic Commerce). “Data message” means information generated, sent, received or stored by electronic, optical or similar means, including, but not limited to, electronic data interchange (EDI), electronic mail, telegram, telex or telecopy (see article 2 (a) of UNCITRAL Model Law on Electronic Commerce).

### **Assets and obligations subject to a security agreement**

12. The law should make it possible to secure all types of obligations, including future obligations and fluctuating amounts of obligations. It should also make it possible to provide security in all types of asset, including fixtures and accessions, as well as in assets which the grantor may not own or have the power to dispose of, or which may not exist at the time of the security agreement, and in proceeds. Any exceptions to these rules should be limited and described clearly in the law.

### **Time of creation**

13. The law should provide that a possessory security right is created at the time the grantor delivers possession or control of the assets to be encumbered to the secured creditor or another third person who holds the assets on behalf of the secured creditor (other than the grantor or an agent or employee of the grantor), unless the parties otherwise agree. A non-possessory security right is created at the time the security agreement is made, unless the parties otherwise agree. A security right in future property is created at the time the debtor or other grantor acquires rights in such property.

## **III. Third party effectiveness**

### **Purpose**

14. The purpose of the provisions of the law requiring an additional step before a security right may be asserted against competing claimants is:

- (a) To alert third persons dealing with the movable assets of the grantor of the risk that those assets may be encumbered by a security right; and
- (b) To provide a temporal event for ordering priority among secured creditors and between a secured creditor and other classes of competing claimants.

### **Methods for achieving third party effectiveness**

15. The law should provide that a security right may be asserted against a competing claimant only when one of the following events occurs:

- (a) Registration of a notice of the security right in a general security rights registry;
- (b) Dispossession of the grantor if the encumbered assets are specific items of tangible movable property;
- [(c) Transfer of control to the secured creditor if the encumbered assets are [certain intangible obligations, other than receivables, owing to the grantor by a third person] [a deposit account];]
- (d) Registration of a notice of the security right in a specialized title registry if the encumbered assets are specific items of movable property for which title is established, under other law of the enacting State, by registration in such a registry; or

(e) Entry of a notation of the security right on the title certificate if the encumbered assets are specific items of tangible movable property for which, under other law of the enacting State, title is evidenced by a title certificate.

16. The law should confirm that different methods for achieving third party effectiveness may be used for different items or kinds of encumbered assets whether or not they are encumbered by the same security agreement or by separate security agreements.

#### **Establishment and characteristics of a general security rights registry**

17. The law should provide for the establishment of a general security rights registry having the following characteristics:

(a) Registration is effected by filing a notice of the security right as opposed to a copy of the security documentation;

(b) The record of the registry is centralized; that is, it contains all notices of security rights registered under the secured transactions law of the enacting State;

(c) The registration system is set up to permit the indexing and retrieval of notices according to the name of the grantor or according to some other reliable identifier of the grantor;

(d) The registry is open to the public;

(e) Reasonable public access to the registry is assured through such measures as:

(i) Setting fees for registration and searching at a cost-recovery level; and

(ii) Making available remote modes or points of access;

(f) The registration system is administered and organized to facilitate efficient registration and searching. In particular:

(i) A notice may be registered without verification or scrutiny of the sufficiency of its content;

(ii) Subject to the financial and infrastructural capacity of the enacting State, notices are stored in electronic form in a computer data base;

(iii) Subject to the financial and infrastructural capacity of the enacting State, registrants and searchers have electronic access to the registry record, or telephone or telecopy access; and

(g) The law provides rules on the allocation of liability for loss or damage caused by an error in the administration or operation of the registration and searching system

#### **Required content of registered notice**

18. To constitute a legally effective registration, the law should require the registered notice to contain [only]:

(a) The names (or other reliable identifiers) of the grantor and the secured creditor, and their addresses;

(b) A description of the movable property covered by the notice;

[(c) The term of the registration [if the State elects to allow registrants to self-select the number of years for which the registration is to be effective] [see Recommendation 25]; and

[(d) A statement of the maximum monetary amount for which the security right may be enforced.]

#### **Legal sufficiency of grantor name in a registered notice**

19. The law should provide that the name or other identifier of the grantor entered on a registered notice is legally sufficient if the notice can be retrieved by searching the registry record according to the correct legal name or other identifier of the grantor. For this purpose, the law should specify rules for determining the correct legal name or other identifier of individuals and entities.

#### **Legal sufficiency of description of assets covered by a registered notice**

20. The law should provide that a description of the assets covered by a registered notice is legally sufficient if it enables a third person to identify the assets covered by the notice separate from other assets of the grantor.

21. If the assets covered by the notice consist of a generic category or categories of movable property, the law should confirm that a generic description is legally sufficient.

22. If the assets covered by the notice are all the present and after-acquired movable property of the grantor, the law should confirm that it is legally sufficient to describe the charged assets as “all movable property” or by using equivalent language.

#### **Advance registration**

23. The law should confirm that a registration may be made before or after the creation of the security right to which it relates.

#### **One registration for multiple security agreements**

24. The law should confirm that a single registration is sufficient for security rights created by all security agreements entered into between the same parties to the extent they cover items or kinds of movable property that fall within the description contained in the registered notice.

#### **Duration and renewal of registration**

25. The law should specify the duration of registration or permit the duration to be selected by the registrant at the time of registration. The law should provide for the right to successively renew the term of a registration.

#### **Discharge of registration**

26. The law should adopt a summary procedure to enable the grantor to compel discharge of a registration if no security agreement has been completed between the

parties or if the security right has been terminated by full payment or performance of all of the secured obligations.

**[Additional rights subject to registration]**

27. The law should provide that the following rights may be asserted against third parties only if notice of the right is registered in the general security rights registry:

[(a) The title of a creditor who retains title to goods to secure payment of the purchase price of the goods or its economic equivalent under an agreement of sale or a financing lease;] and

[(b) The title of:

(i) A lessor under a lease that is not a financing lease but which extends for a term of more than one year;

(ii) An assignee under an outright assignment [sale] of receivables;

(iii) A consignor under a commercial consignment in which the goods are consigned to a consignee as agent for sale other than an auctioneer and other than a consignee who does not act as a consignee in the ordinary course of business;

(iv) A buyer under a sale of goods outside the ordinary course of the seller's business where the seller remains in possession of the goods for more than [thirty] [sixty] [ninety] days; and

(v) A transferee under a transfer of title for security purposes.]

**Dispossession of the grantor**

28. The law should provide that:

(a) Dispossession of the grantor is sufficient only if an objective third person can conclude that the encumbered assets are not in the actual possession of the grantor; and

(b) Possession by a third person constitutes sufficient dispossession only if the third person is not an agent or employee of the grantor and holds possession for or on behalf of the secured creditor.

**Negotiable instruments**

29. The law should provide that dispossession of a negotiable document of title constitutes dispossession of the assets represented by the document during the time that the assets are covered by the document.

**[Transfer of Control over [Intangible Obligations] [Deposit Accounts]**

30. The law should provide that a [person who owes a certain intangible obligation to the grantor] [a depository institution with whom the grantor has a deposit account] is required to respond, within a [prescribed] [reasonable] time, to a written demand from a creditor of the grantor for confirmation of whether control over [the performance of the intangible obligation] [the deposit account] has been transferred to a creditor of the grantor.

31. If the secured creditor and the [person owing the intangible obligation] [the depository institution] are the same person, the law should confirm that the secured creditor acquires control as soon as the security right is created.]

#### **Security rights in proceeds**

32. Where the law recognizes a statutory security right in the identifiable proceeds of the originally encumbered assets, the law should provide that the security right takes effect against third parties as soon as the proceeds arise provided that:

(a) The proceeds take the form of money, negotiable instruments, negotiable documents of title, or receivables [including] [and] deposit accounts;

(b) The proceeds are covered by the description contained in a notice registered in the general security rights registry; or

(c) The security right in the proceeds is independently made effective against third parties by one of the methods referred to in recommendation 15 within [...] days after the proceeds arise.

### **IV. Priority**

#### **Purpose**

33. The purpose of the provisions of the law on priority is to:

(a) Enable a potential secured creditor to determine, in an efficient manner and with a high degree of certainty prior to extending credit, the priority that the security rights would have relative to competing claimants; and

(b) Enable grantors to create more than one security right in the same asset and to thereby use the full value of their assets to facilitate obtaining credit.

#### **Scope of priority rules**

34. The law should have a complete set of priority rules covering all possible priority conflicts.

#### **Secured obligations affected**

35. The law should provide that the priority accorded to a security right:

(a) Extends to all secured monetary and non-monetary obligations owed to the secured creditor [up to a maximum monetary amount set forth in the registered notice] and secured by the security right, including principal, costs, interest and fees; and

(b) Is unaffected by the date on which an advance or other obligation secured by the security right is made or incurred (i.e. a security right may secure future advances under a credit facility with the same priority as advances made under the credit facility contemporaneously with the creation or completion of the security right).

**Priority in after-acquired property**

36. The law should specify that a security right in after-acquired or after-created assets of the grantor has the same priority as a security right in assets of the grantor owned or existing at the time the security right is made effective against third parties.

**Priority in proceeds**

37. The law should provide that a secured creditor's priority with respect to an encumbered asset extends to the proceeds of the asset subject to the requirements of recommendation 32.

**Priority in the case of a change in method for achieving third party effectiveness**

38. The law should provide that if, while a security right is made effective against third parties by one method, it is also made effective against third parties by another method, priority dates as of the time the first method is completed [provided that there was no time gap between completion of the first and the second method].

**Priority of security rights that are not effective against third parties****Unsecured creditors**

39. The law should provide that a secured creditor with a security right that is not effective against third parties has [no right other than an unsecured creditor] [priority over unsecured creditors unless the unsecured creditor has taken steps to reduce its claim to a judgement or the grantor has become insolvent].

**Secured creditors**

40. The law should provide that:

(a) A security right that is not effective against third parties is subordinate to a security right in the same encumbered assets that is effective against third parties, without regard to the order in which the security rights were created; and

(b) Priority among security rights that are not effective against third parties is determined by the order in which they were created.

**Priority of security rights that are effective against third parties****Unsecured creditors**

41. The law should provide that a security right that is effective against third parties has priority over the rights of unsecured creditors.

**Secured creditors**

42. The law should provide that:

(a) As between two security rights in the same encumbered asset that are effective against third parties, except as provided in recommendation 4, priority is determined by the order in which their respective third party effectiveness steps occurred, even if one or more of the requirements for the creation of a security right was not satisfied at such time. If one of the security rights is made effective against

third parties by possession of the encumbered asset, the holder of that security right will have the burden of establishing when it obtained possession;

(b) A security right made effective against third parties by control has priority over a security right made effective against third parties by any other method;

(c) With respect to negotiable instruments, negotiable documents and money, a security right made effective against third parties by possession or control has priority over a security right made effective against third parties by registration.

#### **Purchase money security rights**

43. The law should provide that:

(a) A purchase money security right in goods that has been made effective against third parties by registration within a short specified period after the grantor obtains possession of the goods has priority over a competing non-purchase money security right in the same goods that has been made effective against third parties by prior registration[. Retention of title arrangements should be subject to the same requirements as purchase money security rights]; and

[(b) If the goods subject to a purchase money security right consist of inventory, then, in addition to registration, the law should require that the purchase money creditor give notice before delivery of the goods to the grantor to all other creditors who have previously registered a security right in the same goods in order to obtain priority over those creditors.]

#### **Judgement creditors**

44. The law should provide that, if applicable law gives a judgement creditor rights in assets of the judgement debtor in recognition of the legal steps the judgement creditor has taken to enforce its claims, a security right that is effective against third parties has priority over the right of the judgement creditor that is registered after the security right has become effective against third parties, except with respect to amounts advanced by the secured creditor subsequent to a specified number of days after the date on which the judgement creditor registers a notice of its rights.

#### **Buyers of encumbered assets**

45. The law should provide that the right of a buyer of goods is subject to a security right that has become effective against third parties before the sale, unless the secured creditor authorized the sale, except that a buyer of inventory who buys encumbered assets in the ordinary course of business of the seller (and anyone whose rights to the encumbered assets derive from that buyer) takes free of a security right that is effective against third parties in those assets, even if such buyer has knowledge of the existence of the security right.

#### **Reclamation claims**

46. If the law provides that suppliers of goods have the right to reclaim the goods within a specified time after the grantor becomes insolvent, the law should also

provide that such specified time is short, and that the right to reclaim the goods is subordinate to security rights in such goods that are effective against third parties.

#### **Lessees**

47. The law should address the priority of a security right in an asset that is effective against third parties as against the rights of a lessee of such asset.

#### **Holders of promissory notes and negotiable documents**

48. The law should provide that the rights of a [person who by other law takes rights in a promissory note or negotiable document free of claims to it] [holder in due course of a promissory note or negotiable documents] takes such asset free of a security right that is effective against third parties.

#### **Holders of rights in money**

49. The law should provide that the rights of a person who gives value for money and has possession of the money takes the money free of a security right in the money that is made effective against third parties only by registration.

#### **Statutory (preferential) creditors**

50. The law should limit, both in number and amount, preferential claims that have priority over security rights that are effective against third parties, and to the extent preferential claims exist, they should be described in the law in a clear and specific way.

#### **Holders of rights in assets for improving and storing assets**

51. If applicable law gives rights equivalent to security rights to a creditor who has added value to goods (e.g. by repairing them) or preserved the value of goods (e.g. by storing them), such rights should be limited to the goods whose value has been improved or preserved that are in the possession of such creditor, and should be effective against the holders of security rights in the goods that are effective against third parties only to the extent that the value added by the improvement or preservation directly benefits the holders of the pre-existing security rights. [*Note to the Working Group: The Working Group may wish to consider whether registration should be required.*]

#### **Fixtures**

52. The law should set forth rules governing the relative priority of a holder of a security right in fixtures vis-à-vis persons who hold rights with respect to the related immovable property, such as a person (other than the grantor) who has an ownership interest in the immovable property, a purchaser of such property or a creditor whose security rights extend to the immovable property as a whole.

#### **Insolvency representatives**

53. The law should provide that a secured creditor's priority should continue unimpaired in an insolvency proceeding of the grantor, subject to applicable

provisions of the insolvency laws pertaining to preferential claims and avoidance actions.

**Subordination agreements**

54. The law should recognize agreements that alter the priority of security rights, provided that they affect only the persons who actually consent to such alterations. Such agreements should be binding on such persons even in the case of the insolvency of the grantor of the security rights.

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